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June 4, 2008

Ms. Jennifer J. Johnson, Secretary
Board of Governors
of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Policy on Payments System Risk, Docket No. OP-1309

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the proposed modifications to the Board of Governors of the Federal Reserve System (the Board) Payments System Risk policy.

Background

The Board is seeking comments on changes to its Payments System Risk (PSR) policy designed to improve the banking industry's intraday liquidity management, augment the intraday liquidity provided, and mitigate the growing credit exposures of Reserve Banks given the increasing demands for intraday credit and accompanying daylight overdrafts.

The proposed modifications would address the Board's five major concerns related to risk and efficiency. First, the long-term trend of declining end-of-day

¹ The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing over 282,000 Americans, ICBA members hold more than \$982 billion in assets, \$788 billion in deposits, and more than \$681 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

balances held in Federal Reserve accounts implies an increasing need for intraday credit to fund payments system transactions. Second, financial utilities are absorbing large amounts of intraday funding from participants to meet their risk management requirements and are waiting until late in the afternoon to transfer balances back to participants' reserve accounts, which results in large Fedwire balance transfers late in the day. Third, many large depository institutions are holding a significant number of large-value payments in "liquidity queues" to avoid daylight overdraft fees resulting in delayed payments across the financial markets. Fourth, Board data reflects a significant increase in daylight overdrafts and Reserve Banks' credit exposure. Finally, the increase in daylight overdraft fees has increased the cost burden of the PSR policy on the banking industry.

Specifically, the proposal would: 1) encourage institutions to voluntarily collateralize intraday credit extensions; 2) implement two-tiered pricing wherein the fee for collateralized intraday credit would be zero and the fee for uncollateralized intraday credit would increase from 36 to 50 basis points; 3) modify the single-day daylight overdraft cap; and 4) implement measures to limit the impact of PSR policy changes on small users of intraday credit.

Overview of ICBA Comments

ICBA appreciates the Board's ongoing and evolving commitment to fulfilling the intraday credit needs of the banking industry to foster the smooth operation of the payments system consistent with the Board's fundamental role as the nation's central bank.

ICBA generally supports the Board's proposal to establish a voluntary collateralization program for intraday credit extensions as it balances the needs of Reserve Banks, the payments system, and the banking industry. We particularly support and appreciate the Board's willingness to minimize the burden of the PSR policy on community banks and other small users of daylight overdrafts. ICBA agrees with the proposed net debit cap modifications and supports the Board's anticipated two-year implementation timeline as well.

Furthermore, ICBA strongly recommends the Board carefully evaluate the proposal's impact on bankers' banks executing funds management and settlement on behalf of thousands of community banks using bankers' banks.

ICBA Comments on Specific Provisions

Intraday Credit Collateral and Fees

Under the Board's proposal, Reserve Banks would extend intraday credit to healthy depository institutions² at a zero fee if the credit is secured by eligible collateral. The pledging of collateral would be voluntary and any unencumbered

² A financially healthy institution is defined as at least an adequately capitalized depository institution that has a supervisory rating of CAMELS-3 or higher.

discount window collateral would explicitly collateralize daylight overdrafts. Intraday credit collateral eligibility requirements and margins would mirror discount window requirements and margins. Reserve Banks would have the discretion to accept in-transit securities as eligible collateral. Additionally, the proposal would increase the fee for uncollateralized daylight overdrafts to 50 from 36 basis points (annual rate) to further encourage the pledging of collateral.

ICBA generally supports the Board's proposal to establish a voluntary collateralization program for intraday credit extensions as it provides a balanced approach for addressing the Board's desire to reduce Reserve Bank credit risks and fulfilling the liquidity needs of the payments system and the banking industry without disruption. Moreover, this approach would not impose undue burden on the smaller institutions that use intraday credit but have not signed Reserve Bank borrowing agreements or have not pledged any collateral.

ICBA believes a zero fee for collateralized overdrafts would not be problematic as the early return of securities is a well-established practice. This should not eliminate the incentive for the continued early return of government and agency securities held under certain types of repurchase agreements,

Small Users of Intraday Credit

The Board's proposal would eliminate the daylight overdraft fee deductible and increase the bi-weekly fee waiver from \$25 to \$150. These changes would provide a de minimis amount of free uncollateralized credit to eligible depository institutions and limit the cost burdens on small users³ of daylight overdrafts.

ICBA strongly supports and appreciates the PSR policy special provisions for community banks and other small users of daylight overdrafts. The Board's commitment to recognizing these special needs and minimizing burden is welcomed regulatory relief.

Net Debit Caps

The Board's proposal would eliminate the current two-week average net debit cap and retain the higher single-day cap for healthy depository institutions as an additional incentive to collateralize intraday credit, address anticipated increases in intraday credit demands, and limit the amount of intraday credit extended to an individual institution. This change, if adopted, would increase the routine daylight overdraft capacity of healthy institutions with self-assessed caps approximately 50 percent from the existing policy. Additionally, the single-day cap would apply to the total of uncollateralized and collateralized daylight overdrafts. Under the proposal, the Board would also afford Reserve Banks additional administrative flexibility if an institution incurs a fully-collateralized overdraft above its single-day cap.

³ An institution is defined as a small user of daylight overdraft credit if the institution has an exempt cap, which is the smallest positive cap under the policy, or if the institution averages less than \$1 million a day in daylight overdrafts. The Board has historically considered exempt-cap institutions to be small users of daylight overdrafts. 73 FR. 12426 (March 7, 2008).

ICBA agrees with the Board's proposed net debit cap modifications. These modifications would provide a reasonable and complimentary two-tiered approach for mitigating Reserve Bank and counterparty credit risk and meeting any increased intraday credit needs of individual institutions. Generally, community banks would have "exempt-from filing"⁴ or "de minimis"⁵ net debit caps and would need to perform a self-assessment to support a higher net debit cap category. However, community banks with higher net debit caps would likely benefit from the proposed modifications.

Implementation

ICBA supports the Board's proposed two-year implementation timeline as it would provide all stakeholders sufficient time to make the necessary modifications to internal processes and systems.

Bankers' Banks

The current PSR policy generally affords community banks and other small users of intraday credit the flexibility to meet their funding needs, and the Board's proposal would provide additional flexibility. However, in the case where a community bank uses a settlement agent, such as a bankers' bank, its entries are aggregated with other community bank entries through the agent's own Federal Reserve account.

It is ICBA's understanding that bankers' banks are exempt from reserve requirements and do not have regular access to the discount window. Due to bankers' banks access to the Federal Reserve payments services, they must pledge collateral to cover any overdrafts they incur. We further understand the PSR policy allows bankers' banks to waive their exemption from reserve requirements to obtain discount window access and intraday credit.

ICBA encourages the Board to remain mindful of the proposal's impact on bankers' banks and the likelihood that they would need to hold higher account balances overnight or obtain funding earlier. Both resolutions would be disruptive to bankers' banks operations and potentially their community bank respondents.

ICBA strongly recommends the Board carefully evaluate the proposal's impact on bankers' banks executing funds management and settlement on behalf of thousands of community bank customers. Additionally, ICBA recommends the Board grant Reserve Banks broad, but prudent, discretion to work with bankers' banks on a case-by-case basis to address any consequences resulting from the policy modifications.

⁴ The net debit cap for the exempt-from-filing category is the lesser of \$10 million or 20 percent of the depository institution's capital.

⁵ The net debit cap for the *de minimis* category may be up to 40 percent of the depository institution's capital if its board of directors submits a resolution approving the institution's use of intraday credit up to the *de minimis* level.

Conclusion

Overall, ICBA supports the Board's proposal to establish a voluntary collateralization program for intraday credit extensions as it balances the needs of Reserve Banks, the payments system, and the banking industry. We particularly support and appreciate the Board's efforts to minimize the burden of the PSR policy on community banks and other small users of intraday credit.

ICBA strongly recommends the Board carefully evaluate the proposal's impact on bankers' banks executing funds management and settlement on behalf of thousands of community banks using bankers' bank services. Additionally, we strongly recommend the Board afford Reserve Banks broad, but prudent, authority to address any consequential burdens placed on bankers' banks.

Thank you for the opportunity to comment. If you have any questions or would like additional information, please contact the undersigned by telephone at (202)659-8111 or by email at viveca.ware@icba.org.

Sincerely,

/s/

Viveca Y. Ware
Director, Payments & Technology Policy